MICHIGAN CORPORATION & SECURITIES BUREAU

RELEASE NO. 84-25

TO: ALL INTERESTED PARTIES

SUBJECT: Corporate Equities Rule Interpretations, Rule 706.26

Since its adoption in December 1983, several questions regarding the Bureau's interpretation of the new corporate equities rule, Rule 706.26, have arisen. This release is designed to answer some of those questions.

1. Q. In Section (1)(b)(i), the continuing commitment of key management is met if key management continues to have equity ownership of 10% of the shares outstanding after completion of the offering. When is this test applied and does the 10% ownership refer to the number of shares or the value of the shares outstanding?

   A. Key management must own 10% of the number of shares of the corporation outstanding immediately after completion of the public offering. The Bureau has determined, however, that in a company still in the development stage, key management must be "at risk" along with the public investors or this will be considered as a factor in finding that "unusual circumstances" exist and therefore justifying a complete review of the offering. This position is predicated on the underlying concept that there must be an assurance that key management will remain in the business for a reasonable time after the offering. (See paragraph 3 below.)

2. Q. Section (1)(f) defines a "qualified underwriter" as a managing underwriter registered with the New York Stock Exchange or otherwise determined by the Bureau to be qualified. If the managing underwriter is not a New York Stock Exchange member, but one or more of the selling syndicate underwriters are members, does the offering qualify for the Rule?

   A. No. Because the primary pricing and due diligence responsibilities are with the lead or managing underwriter, it is the qualifications of that underwriter that the Bureau will consider. The presence of qualified underwriters in the syndicate may be important when requesting the Bureau to designate a NYSE nonmember underwriter as qualified.

3. Q. What constitutes "unusual circumstances" under Section (2) of the Rule?

   A. It is impossible to present a list of all matters that would cause the Bureau to disqualify an offering under the Rule because they would constitute "unusual circumstances." Among them, however, might be:

      (1) Key management is not "at risk." As was previously indicated, the Bureau is concerned, particularly in the case of a developmental company, that those members of the company's management who are critical to the success of the business remain with the company. Consequently, the Bureau will require that such persons be "at risk" in the venture.

      As a general policy, the Bureau will require that such members of management have "at risk" an amount in cash and property equal to 10% or more of the minimum or impounded amount of the proposed public financing. At the discretion of the administrator, the reasonable value of both tangible and intangible property may be included in computing the "at risk" amount.

      (2) The presence of parties described in Regulation A, 17 C.F.R. §§252(c), (d), (e) & (f) who would be subject to the disqualification provision of Rule 803.6.

4. Q. What standards will be applied to established companies not qualifying for Sections (2)(a) or (b) of the Rule?

   A. Established companies not qualified for Sections (2)(a) or (b) will be reviewed with less emphasis on the continuing commitment of key management. The other requirements of Section (2)(c) may serve as a guideline in reviewing corporate offerings of such nondevelopmental companies.

5. Q. What standards will be applied to offerings that do not meet any of the conditions of Rule 706.26 now that most of the merit standard rules have been rescinded?

   A. The Bureau's mandate remains Section 306(a)(2)(E). In determining whether an offering not eligible for consideration under Rule 706.26 is being offered on "unfair terms," the Bureau will refer to the North American Securities Administrators Association Statements of Policy on Cheap Stock dated April 28, 1984; on Existing Capitalization dated April 28, 1984; on Non-Voting Stock dated September 17, 1980; on Options and Warrants dated October 7, 1971; the Central States Administrators Council Statements of Policy on Loans to Company Officials dated April 22, 1978. Matters not covered by these Statements of Policy will be evaluated for fairness by the staff based on more subjective review.

6. Q. The definition of "developmental company" means a company making an initial public offering where there is either no established market value for the securities of the company or where the company has no significant earnings. Does a company with a history of earnings but no market for the securities fall within the definition of "developmental company"?

   A. No. Companies with a history of operations and earnings will not be classified as a "developmental company" notwithstanding that there may not be an established market for the securities.

Questions concerning these interpretations should be directed to the Examinations Division of the Bureau. Unless withdrawn or modified, this action shall become the policy of the Bureau 30 days from this date.

Authority:

Act 265 of 1964, Section 413.

Signed by E. C. Mackey, Director
Corporation & Securities Bureau
Dated: June 4, 1984

(3) A corporation purchases the assets and assumes the liabilities of a business trust or REIT in exchange for its stock. The trust or REIT is then terminated and the corporation stock distributed in liquidation to the beneficial owners of the trust or REIT. The transaction involving the exchange of assets for stock and the termination of the trust is subject to approval by a majority vote of the beneficial owners and is similar to the vote of shareholders in approving a corporate sale of the assets and dissolution.

Action or Interpretation:

In interpreting the statute, the Bureau has determined that the exemption from registration contained in Section 402(b)(19) is available in the above described fact situations. In each instance, the transaction is sufficiently analogous to those specified in Section 402(b)(19) that registration is not required for investor protection.

The Bureau will no longer issue no action letters or interpretive opinions in these fact situations. Requests for no action letters or interpretive opinions relating to Section 402(b)(19) must be accompanied by a statement of facts describing a situation different from those outlined above. Such requests should be addressed to the Examination Division of the Corporation and Securities Bureau and should be prepared in accordance with the Bureau's Release No. 81-3.

Authority:

Act 265 of 1964, Section 402(b)(19).

Signed by E. C. Mackey, Director
Corporation & Securities Bureau
Dated: July 26, 1982